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CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM AND FLORIDA STATE BOARD OF ADMINISTRATION,
Petitioners,

v.

PAUL FELZEN, ET AL.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF FOR BARCLAYS GLOBAL INVESTORS, N.A., STATE OF WISCONSIN INVESTMENT BOARD, AND CERTAIN OTHER INSTITUTIONAL INVESTORS AS AMICI CURIAE SUPPORTING PETITIONERS

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The institutional investors listed in the Appendix ("Institutional Investors") respectfully submit this brief as amici curiae supporting the petitioners, California Public Employees' Retirement System and Florida State Board of Administration.[1] The Institutional Investors believe that the

[1] The parties consented to the filing of this brief. Their letters of consent are on file with the Clerk of the Court.

Counsel for a party did not write any part of this brief. The (continued...)

Seventh Circuit's rule requiring a shareholder that plans to object to the terms of settlement in a derivative case to intervene to preserve its ability to appeal imposes unnecessary and undue costs and will deter meritorious appeals. They therefore request the Court to reverse the Seventh Circuit and permit the Petitioners to appeal the settlement of the derivative case without intervening.

INTEREST OF THE AMICI CURIAE

Each of the Institutional Investors listed in the Appendix has a significant interest in the resolution of this case. The Institutional Investors have sizable securities holdings in a large number of U.S. corporations and are often among the securities owners represented by the named shareholders in shareholder derivative actions. They therefore favor legal rules permitting them to improve the terms of derivative case settlements without encountering unnecessary costs and procedural hurdles.

Each Institutional Investor is a large private or public investment fund or the investment manager for such a fund with tens of billions of dollars under management. The amici along with other institutional investors[2] "are America's largest shareholders, with about $9.5 trillion in assets,

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[1] (...continued)
Council of Institutional Investors, which is an association of institutional investors, made a monetary contribution to the preparation and filing of this brief.

[2] Institutional investors take many forms, such as banks, mutual funds, and private and public pension funds. See Margaret Blair, Ownership and Control 147-65 (1995); Robert A. G. Monks & Nell Minow, Corporate Governance 120-45 (1995).

accounting for fifty-one percent of the equity market."[3] Of the Institutional Investors, Barclays Global Investors, N.A. manages, administers, or advises on the investment of over $500 billion in assets. The New York State Common Retirement Fund has assets with a value of approximately $105 billion. The New York City pension funds have assets of over $84 billion, and the New York State Teachers' Retirement System has approximately $70 billion.

At any one time, each Institutional Investor generally owns or manages the securities of hundreds or thousands of issuers, roughly half or more of which are U.S. corporations. For example, Barclays Global has approximately $320 billion of its $500 billion in assets under management invested in U.S. securities, mostly equities. The New York City funds own approximately $50 billion of U.S. equities out of total holdings of $84 billion. The New York State Common Retirement Fund has approximately $52 billion invested in the common stock of more than 1,600 different U.S. issuers.

A fund's stake in the common stock of a U.S. company ranges from a small fraction of one percent to over 17 percent. The State of Wisconsin Investment Board ("SWIB") owns more than 10 percent of 35 companies. The investment of the New York State Common Retirement Fund in a single issuer ranges from a few thousand dollars to over $1 billion.

The Institutional Investors manage their holdings on behalf of millions of individual beneficiaries. The New York City pension systems have more than 540,000

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[3] H.R. Conf. Rep. No. 104-369, at 34 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 733.

participants, including beneficiaries, retirees, vested members, and active members. SWIB has over 435,000 participants, who are state, university, public school, and local government employees. The New York State Common Retirement Fund has approximately 867,000 members and beneficiaries.

The objective of the Institutional Investors is to maximize the long-term return on their securities investments for the benefit of all their individual participants, and they do that by, among other things, monitoring and exercising their shareholder authority over the boards of directors and managers of corporations in which the funds invest. Derivative actions are one of the important methods shareholders use to hold directors and officers accountable for the conduct of corporate affairs. Given that the great majority of derivative actions are settled rather than litigated, the Institutional Investors therefore have a substantial interest in a resolution of this case that enhances their opportunities to affect the terms on which derivative cases are settled.

SUMMARY OF ARGUMENT

The Court should reverse the ruling of the Seventh Circuit in this case because requiring an objecting shareholder to intervene to preserve its ability to appeal a district court approval of a derivative settlement would prevent meritorious appeals. Because a decision to intervene has significantly greater costs and legal consequences than a decision to object or appeal, a variety of practical constraints on institutional investors would prevent them from making timely intervention decisions in all cases in which an appeal might be needed. These practical constraints include inadequate time to consider proposed settlement terms, lengthier procedures for making decisions to intervene, and

limited resources for coping with the larger responsibilities associated with intervention. In addition, in derivative cases in federal court based on diversity of jurisdiction, many shareholders would probably not be able to intervene because doing so would destroy complete diversity. As a result, an intervention requirement would effectively deny many institutional investors their ability to appeal.

Denying institutional investors an opportunity to appeal would harm the judicial process because the number of inadequate and unfair settlements would increase. Appeals by objecting, non-intervening shareholders have in the past successfully challenged derivative settlements approved by district courts, and the loss of the threat of appeal would diminish a shareholder's ability to improve settlement terms at the district court level.

Federalism and *Erie* considerations also favor permitting shareholders to appeal without intervening. States have a strong interest in preventing unfair and inadequate settlements of derivative cases based on state law claims, and several states that are preferred locations for incorporation and shareholder derivative cases do not require an objecting shareholder to intervene before appealing. The Court should take this state practice into account in determining whether an objecting shareholder in federal court must intervene to appeal.

ARGUMENT

I. REQUIRING INTERVENTION BEFORE APPEAL WOULD PREVENT MERITORIOUS APPEALS BY DENYING MANY INSTITUTIONAL INVESTORS THEIR ABILITY TO APPEAL.

The Institutional Investors strongly believe that, because of differences between a decision to intervene and a decision to object or appeal, requiring an objecting shareholder to intervene to preserve its ability to appeal a district court approval of a derivative settlement would prevent meritorious appeals. An intervention requirement would prevent appeals because intervention imposes unnecessary costs in the circumstances of a settlement challenge and because a variety of practical constraints on institutional investors would prevent them from making a timely decision to intervene in all cases in which they might decide that an appeal is warranted. In addition, in derivative cases in federal court based on diversity of jurisdiction, many shareholders would probably not be able to intervene because doing so would destroy complete diversity.

In the next sections of the brief, we address these issues. We then explain that discouraging appeals by institutional investors will harm the judicial system and finally discuss why requiring only a limited form of intervention for purposes of appeal would not fully address the concerns of the Institutional Investors.

A. Because of the differences between intervention and objection, institutional investors cannot, as a practical matter, make timely intervention decisions in all cases in which an appeal might be warranted.

1. A decision to object or appeal is substantially different from a decision to intervene.

A decision to object to a settlement or appeal the approval of a settlement of a derivative case is substantially different from a decision to intervene. An objector or an appellant generally has a narrow and specific disagreement or set of disagreements with a proposed settlement. For example, the shareholder might believe that the proposed payment of legal fees is too high[4] or that the money damages payable to the corporation are too low. As in this case, the objector might challenge the adequacy or effectiveness of the proposed changes in the structure of the board of directors or in the system of corporate governance.

An objector, taking into account the uncertainties of proceeding to trial, seeks to ensure that the terms of the settlement adequately compensate the corporation for the alleged misconduct and harm to the corporation. An objector's goal is not to control the prosecution of the case and establish the liability of the defendants.

A decision to intervene has broader purposes and more significant legal consequences. For several reasons, an intervening shareholder assumes more responsibility and

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[4] See, e.g., Rosenbaum v. MacAllister, 64 F.3d 1439 (10th Cir. 1995) (in combined class and derivative action, objector challenged only attorney fee award and not settlement agreement as a whole).

faces a considerably greater commitment of time, energy, and resources than an objecting shareholder.

First, to comply with Rule 24 of the Federal Rules of Civil Procedure, an intervenor must file a motion to intervene and must include a pleading setting forth the claim or defense for which intervention is sought. Before filing the pleading, the intervenor must conduct sufficient due diligence to satisfy the requirements of Rule 11. If the motion is opposed, the intervenor must reply and, if the motion is denied, appeal.

Second, a successful intervenor has party status.[5] A shareholder intervening in a derivative case becomes one of the plaintiffs pursuing the best interests of all the shareholders and of the corporation[6] and making all the decisions a client in litigation makes. It has responsibilities for prosecuting the case, for collecting evidence, for establishing the liability of the defendants, and for obtaining the best possible relief by settlement or judgment.

Third, an intervenor bears all the burdens of a party. It becomes subject to all discovery provisions applicable to a party, such as the obligation to make initial disclosures and answer interrogatories. The other parties may obtain documents and depositions from an intervenor much more easily than from a person not a party.

These differences between intervening and objecting to a settlement and perhaps appealing the trial court's approval of the settlement materially affect a shareholder's cost-benefit

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[5] 7C Charles Alan Wright et al., Federal Practice and Procedure § 1920 (2d ed. 1986).

[6] See Smith v. Ayres, 977 F.2d 946, 949 (5th Cir. 1992).

analysis when deciding whether to take a position in a particular case. For each case, a shareholder must evaluate whether the benefits it will receive either in the particular case or across its portfolio are likely to exceed the costs, including lost opportunities, to it or its beneficiaries of taking action, subject to the chance of being reimbursed some or all of its legal fees and costs.

Requiring intervention would disproportionately increase the costs and stakes when compared with the objective or the potential benefit. A shareholder with an objection to the terms of a proposed settlement has a limited and particular goal accompanied by discrete and manageable costs, even taking into account the possibility of an appeal. Intervention on the other hand dramatically increases the shareholder's responsibilities and cost exposure with little or no corresponding benefit. An institutional investor would need to consider whether assuming these broad obligations of an intervenor would be consistent with its fiduciary duties to its beneficiaries, an issue that does not arise in connection with an objection or appeal. These additional and disproportionate costs would discourage intervention.[7]

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[7] See Elliott J. Weiss & John S. Beckerman, Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions, 104 Yale L.J. 2053, 2095-103 (1995) (describing procedures in class actions that deter institutional investors from acting as named plaintiffs); see also note 15 and accompanying text below.

2. Practical constraints on institutional investors prevent them from making timely intervention decisions in all cases in which an appeal might be warranted.

For a variety of practical reasons related to the way that institutional investors and shareholder derivative cases actually operate, the differences between intervention and objection or appeal mean that an intervention requirement would effectively deny many institutional investors their ability to appeal. Institutional investors typically receive inadequate notice of proposed settlements, have lengthy procedures for making decisions as important as intervention, and have limited budgets and personnel to devote to shareholder litigation.

Short notice. Most of the Institutional Investors typically own the securities of over 1000 U.S. corporations. Monitoring costs prevent them from learning of every derivative case filed in federal court on behalf of a corporation in which they own securities. As a result, institutional investors often learn of a derivative case and the proposed settlement at the same time, when the notice of the settlement arrives in the mail.[8] Even when a shareholder is generally aware that a derivative case is pending, it usually does not learn of the specific terms of a proposed settlement

[8] See Bell Atlantic Corp. v. Bolger, 2 F.3d 1304, 1309 n.9 (3d Cir. 1993); Weiss & Beckerman, supra note 7, at 2100-01; Jonathan R. Macey & Geoffrey P. Miller, The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform, 58 U. Chi. L. Rev. 1, 20 (1991).

Other types of cases now involve a requirement for earlier notice. Since 1995, a plaintiff in a class action alleging a violation of the federal securities laws must publish a notice about the pendency of the case. See, e.g., 15 U.S.C. § 78u-4(a)(3)(A).

until it receives formal notice.

In this case, for example, shareholders had less than five weeks to react to the terms of the proposed settlement. The district court entered an order on May 30, 1997 providing for notice to shareholders of the settlement and requiring written objections by July 3, 1997.

Occasionally, the notice is even shorter. SWIB, one of the amici Institutional Investors, regularly receives notice a week or less before a settlement hearing and, in one derivative case,[9] received no formal notice, learning informally from another shareholder that objections to a settlement were due in two days.

These short notice periods mean that an institutional investor has only a limited amount of time to assess the case and the proposed settlement and decide on a course of action. Formulating objections in these time periods is difficult, but, as we now describe, reaching a decision to intervene requires even more time.

Long decision-making processes. Because of the significant legal and financial consequences of intervention discussed above, most institutional investors have lengthy procedures for making a decision to intervene or become a party. The procedure usually takes several months and can take much longer. Generally, although the internal procedures of the Institutional Investors differ, they do not need to obtain the same level of approval or follow the same lengthy decision-making process to file an objection to a proposed derivative settlement or to appeal a settlement

[9] Barney v. Hubbard, No. 692583 (Super. Ct., San Diego County, Cal. 1996).

approval as they do in deciding to intervene as a party.

The typical procedure is for a staff lawyer or outside counsel retained specifically for the matter to evaluate the case and prepare an analysis and recommendation that considers the likelihood of success, the likely recovery, and the probable costs of intervening or objecting.[10] If the senior staff approves the recommendation, the board of nearly all the Institutional Investors must also approve. Boards generally meet only monthly or quarterly, and items to be discussed usually must be on the agenda well in advance. Although many boards have emergency meeting procedures, they are generally not intended to be used for litigation matters. After the board decides to proceed, further approvals, such as from the state attorney general or the city attorney, are sometimes needed. At many of the Institutional Investors, the entire process to reach a decision to intervene would take three to four months.

Several factors account for this careful deliberative process. The process reflects the fiduciary duties institutional investors owe to their beneficiaries under the Employee Retirement Income Security Act or comparable federal or state statutes.[11] In derivative cases, when the recovery goes to the corporation and benefits all shareholders, the probable costs of intervention nearly always exceed the likely benefits to the particular fund,

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[10] Weiss & Beckerman, supra note 7, at 2117.

[11] See Blair, supra note 2, at 156-64; Weiss & Beckerman, supra note 7, at 2112-20; Amendments to Beneficial Ownership Reporting Requirements, Exchange Act Release No. 34-39538, 66 SEC Docket (CCH) 596, 601 (Jan. 12, 1998) ("The Commission believes that these plans [public pension plans] are now generally subject to fiduciary obligations and standards for investment that are substantially similar to those imposed by [Employment Retirement Income Security Act].").

unless the investor receives beneficial broader portfolio effects from the action. Fund managers therefore must select wisely and choose to participate only in those cases offering the potential for setting a useful precedent or deterring similar misconduct in other companies.[12] The lengthy deliberative process also reflects that many of the boards are public bodies subject to administrative law requirements[13] and have many members with diverse perspectives and different interests.

Limited resources. Most institutional investors have extremely limited resources, in part as a result of the need to keep the costs of investment services down or to comply with statutory obligations requiring administrative expenses to be kept at a reasonable level. Adding an intervention requirement would strain these limited resources and tax the ability of institutional investors to react to notices of proposed settlements, prepare careful evaluations for their boards about the implications of intervention, and make the commitment required of an intervenor.

Many institutional investors, especially public pension funds, have small legal budgets and small legal staffs. Even large public funds generally employ no more than five or six lawyers and a few paralegals to handle all of the legal work of the fund, including investor issues, real estate transactions, and disputes with beneficiaries. The annual

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[12] See generally Keith L. Johnson, Deterrence of Corporate Fraud Through Securities Litigation: The Role of Institutional Investors, 60 L. & Contemp. Prob. 155, 159 (1997); Bernard S. Black, Agents Watching Agents: The Promise of Institutional Investor Voice, 39 UCLA L. Rev. 811, 834-35, 839 (1992).

[13] See, e.g., Cal. Education Code §§ 22350-62 (West 1994 & Supp. 1998) (guidelines governing investment of funds in the California State Teachers' Retirement System).

legal budgets of the Institutional Investors vary depending on several factors, such as the nature of the investments, but generally are lean. The budget at many institutional investors for inside and outside lawyers for all matters ranges from approximately $150,000 to $500,000, although some have substantially larger amounts. Public funds often need legislative approval for budget increases or special appropriations.

These limitations are practical constraints on institutional investors inclined to object or appeal, but they take on much greater significance when an institutional investor considers intervention because of the larger consequences of intervention. The limited resources restrict the efforts of institutional investors to monitor shareholder litigation, react to proposed settlements, prepare intervention recommendations for their boards, and then prepare the papers and muster the resources, such as litigation lawyers, to intervene.

The limited resources also restrict the ability of institutional investors to intervene because the increased responsibilities of intervening require more money and staff time than objecting or appealing. Responding to broad and potentially abusive discovery requests[14] distracts investment staff from their normal functions and can result in the loss of profitable trading opportunities. Supervising the lawyers representing the intervenor also involves a substantial commitment of time and attention.

The Assistant General Counsel of SWIB recently summarized the risks and costs that institutional investors perceive as disincentives to becoming plaintiffs in securities

[14] See Weiss & Beckerman, supra note 7, at 2102-03.

class actions:

> Their concerns include costs associated with exposure to discovery, time needed to manage the litigation, possible public disclosure of proprietary investment information, and fear that other plaintiffs who disagree with how the case was handled might sue them.[15]

These same factors would cause institutional investors to proceed with greater care when considering whether to intervene in a derivative case.

In sum, the greater burdens and costs associated with intervention, the need to follow long, careful decision-making procedures before becoming a party, the diversion of limited resources, and other costs create practical obstacles to the ability of institutional investors to intervene in a timely way in shareholder derivative cases. The relatively small number of institutional investors that have become lead plaintiffs under the terms of the Private Securities Litigation Reform Act evidence these problems.[16]

B. The need for complete diversity of citizenship would frequently prevent objecting shareholders from intervening.

Because a shareholder intervening in a derivative action has the status of a party plaintiff, it must have an

[15] Johnson, supra note 12, at 159 (1997) (citing Office of the General Counsel, Securities and Exchange Commission, Report to the President and Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995, at 51 (1997)).

[16] See Johnson, supra note 12, at 159.

independent basis for federal court jurisdiction.[17] In derivative cases, the usual basis is diversity of citizenship because the claims are commonly allegations of breach of fiduciary duty by officers or directors in violation of state law. If the citizenship of the proposed intervenor would eliminate complete diversity, a substantial risk exists that, since the 1990 adoption of the supplemental jurisdiction statute, the district court would deny intervention.[18] At a minimum, the shareholder would face uncertainty and increased costs of litigation in connection with the proposed intervention, each of which would deter participation.

As a result, the rule of the Seventh Circuit obstructs the

[17] 6 James W. Moore et al., Moore's Federal Practice § 24.22[1]-[2] (3d ed. 1997); 7C Wright et al., supra note 5, § 1917.

[18] See 28 U.S.C. § 1332; Snyder v. Harris, 394 U.S. 332, 340 (1969) (the citizenship of the named plaintiffs in a class action must be diverse from the citizenship of the defendants); Central Wesleyan College v. W.R. Grace & Co., 6 F.3d 177, 186 n.3 (4th Cir. 1993) (same); 28 U.S.C. § 1367 (in a diversity case, a court shall not have supplemental jurisdiction over claims by persons "seeking to intervene as plaintiffs under Rule 24 ... when exercising such jurisdiction would be inconsistent with the jurisdictional requirements of section 1332."); Development Fin. Corp. v. Alpha Housing & Health Care, Inc., 54 F.3d 156, 159 (3d Cir. 1995); Krueger v. Cartwright, 996 F.2d 928, 933 n.6 (7th Cir. 1993); Liberty Mutual Group v. Hillman's Sheet Metal, 168 F.R.D. 90, 92 (D. Me. 1996) ("[T]he weight of authority supports the conclusion that § 1367(b) precludes the exercise of supplemental jurisdiction over claims by nondiverse plaintiff-intervenors, even as of right under Rule 24(a)."). But see Costain Coal Holdings, Inc. v. Resource Investment Corp., 15 F.3d 733 (7th Cir. 1994) (reasserting rule that diversity is destroyed only if the nondiverse intervenor was indispensable at the time the complaint was filed); Grossheim v. Freightliner Corp., 974 F.2d 745 (6th Cir. 1992) (intervention of nondiverse silent party plaintiff did not destroy diversity jurisdiction because intervenor was not an indispensable party when litigation commenced).

ability of many objecting shareholders to appeal when a derivative case is based on diversity of citizenship and the citizenship of the objector is the same as any defendant. Either trial courts would deny intervention to preserve complete diversity or shareholders would not seek to intervene because of the costs of litigating the issues over intervention. Without intervening, the shareholder could not appeal, and its objections, if filed at all, would carry reduced weight with the parties and the court. Accordingly, the Court should not impose an intervention requirement unless it also determines that intervention by a plaintiff with the same citizenship as a defendant does not destroy diversity.

C. Denying appeals by institutional investors would prevent meritorious appeals.

Because imposing an intervention requirement would prevent institutional investors as a practical matter from appealing or threatening to appeal derivative settlements, the number of inadequate settlements would increase, and that would significantly undermine the fairness of, and respect for, the judicial process. History shows that appeals by non-intervening shareholder objectors will in some cases be all that prevents an unfair settlement from receiving final judicial approval. Even if there is some slight benefit to be derived from the intervention requirement imposed by the court below -- which the Institutional Investors contest -- it would be dwarfed by the harm flowing from the reduced ability of the federal appellate courts to assure that the judicial imprimatur is not placed on unjust derivative settlements.

The efficacy of the current judicial process for assuring the adequacy and fairness of derivative and class settlements

has already been criticized.[19] The troubling shortcomings of this system flow from the acknowledged problem that frequently none of the settling parties has an incentive to assure that all material information relating to the fairness determination is brought to the attention of the trial or appellate court.[20] Sometimes justice prevails only because a non-intervening objector was able to challenge a settlement on appeal.[21]

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[19] In a study of shareholder suits from the late 1960s through 1987, approximately two-thirds of the derivative suits settled, and the settlements typically produced at best negligible monetary payouts and essentially cosmetic structural relief. Roberta Romano, The Shareholder Suit: Litigation Without Foundation?, 7 J.L. Econ. & Org. 55, 70, 84 (1991). See generally 2 ALI, Principles of Corporate Governance: Analysis and Recommendations 4-16, 183-96 (1994).

[20] This problem often occurs because the derivative plaintiff's counsel, not the plaintiff itself, has the most at stake:

> In the context of shareholder derivative suits and class actions that concern publicly held corporations, it is in reality usually the lawyer rather than the client who makes the important litigation decision about whether to settle and for how much. The actual shareholder client often has, at best, a nominal economic stake in the outcome of the litigation. Therefore, shareholders often lack sufficient economic interest to pay the information costs and expend the energy required to keep abreast of the progress of the litigation and to make informed decisions. . . . This conflict of interest may lead lawyers in derivative suits or class actions to enter into settlement agreements with the defendant directors and officers before the suits reach trial, even though they might have had a realistic chance of obtaining favorable judgments for their clients.

Tim Oliver Brandi, The Strike Suit: A Common Problem of the Derivative Suit and the Shareholder Class Action, 98 Dick. L. Rev. 355, 389 (1994) (footnotes omitted).

[21] See, e.g., Rosenbaum v. MacAllister, 64 F.3d 1439 (10th Cir.

(continued...)

A recent example of the importance of non-intervenor appeals in class and derivative actions is this Court's ruling in *Amchem Products, Inc. v. Windsor*,[22] a case the Court selected to clarify class certification standards in settlements. *Amchem* involved a settlement approved by the district court and overturned in an appeal the Third Circuit allowed by non-party class members that had not been permitted to intervene. This Court ruled that the district court, in an understandable desire to approve the settlement of a complex array of cases, glided too easily past certain requirements of Rule 23, including important considerations relating to intra-class conflicts of interest. The guidance for future cases provided by *Amchem*, and the increased fairness of the settlement process for the asbestos claims in that case, were the direct result of an appeal by non-intervenor objectors.

Imposing a formal intervention requirement would make the problems with derivative case settlements more acute. The costs of participation would increase, closing the doors of the appellate courts to institutional investors in many cases

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[21] (...continued)

1995) (non-intervenor appellant successful in challenging excess attorney's fees in settlement of class and derivative action); In re Pittsburgh & Lake Erie R.R. Co. Sec. & Antitrust Litig., 543 F.2d 1058 (3d Cir. 1976) (settlement involving payments to attorneys and minority shareholder overturned on appeal by non-intervening objector because detriment to the corporation far outweighed any benefits it received); Cohen v. Young, 127 F.2d 721 (6th Cir. 1942) (derivative settlement approved on the basis of purported insolvency of defendant overturned on appeal because lower court failed to undertake an informed assessment of the supposed insolvency).

Another lesson of the cases is that frivolous or meritless appeals have not been a problem. In any event, to the extent that problem does occur, other sanctions, such as Rule 38 of the Federal Rules of Appellate Procedure, are available and adequate.

[22] 521 U.S. 591, 117 S. Ct. 2231 (1997).

and preventing appellate review of some inadequate and collusive settlements. Because of the absence of the threat of appeal, an objecting but non-intervening shareholder would be less effective with the trial judge and would have a weaker hand in negotiations with the parties for better settlement terms. Some shareholders might even decide not file objections if they do not have the power of an appeal behind them. Because the system of justice would suffer, the Court should make review by the appellate courts of derivative and class settlements as barrier-free as possible.

D. Requiring a limited form of intervention for purposes of appeal would not fully address the concerns of institutional investors.

One of the issues raised but not resolved by the decision of the Seventh Circuit is whether intervention by an objecting shareholder for purposes of appealing approval of a settlement may be something short of or different from the intervention contemplated by Rule 24. If it may, the full weight of the responsibilities and burdens of intervention described above might not fall on a shareholder intervening for purposes of appeal. For example, the Court possibly could rule that an objecting shareholder must intervene to appeal but that the motion may be perfunctory, no pleading is required, the trial court should grant the motion in all but extraordinary circumstances, and the intervenor has no greater obligation than to pursue an appeal for its own interests.

Even if the Court were to use this case to define the precise scope and consequences of a limited intervention for purposes of appeal with sufficient precision to avoid the continued costs of further lower court litigation over those issues, such an outcome would address some but not all of

the concerns of the Institutional Investors. First, residual risks of bearing the load of a full intervention would remain and would inevitably affect decisions of institutional investors. A shareholder that intervenes to appeal approval of a settlement would retain its position as an intervenor if the appeal is successful and the case is remanded for further proceedings. It would then likely feel pressure from the court or an obligation to continue assisting in the litigation of the case.

Second, if intervention for purposes of appeal is different from standard intervention, requiring an objecting shareholder to engage in the ministerial act of filing a document called a motion to intervene having no significant legal consequences other than permitting an appeal would be an exercise in empty and wasteful formalism.[23] It would add unnecessary legal costs and burdens while serving no legitimate judicial interest.

Third, permitting a limited form of intervention for purposes of appeal would presumably not benefit the Petitioners in this case because they did not seek any form of intervention. Thus, the objectionable settlement reached in this case would remain intact unless the Petitioners have an ability to move for intervention on remand. Finally, although some courts have recognized forms of limited intervention,[24] the terms of the existing statutes and rules do not provide for such a procedure or intervention for purposes

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[23] See Taylor v. Voss, 271 U.S. 176, 187 (1926) (construing a statute to remove "in large measure the technical questions of procedure which has so greatly obstructed its efficient administration, and served in so many instances as a trap, not intended by Congress, to unwary persons enmeshed in abstruse perplexities.").

[24] Moore, supra note –, § 24.23[1].

of appeal. They provide only for full intervention.[25]

II. FEDERALISM AND *ERIE* CONSIDERATIONS FAVOR PERMITTING SHAREHOLDERS TO APPEAL WITHOUT INTERVENING.

States have a strong and legitimate interest in preventing collusive and inadequate settlements of derivative actions because they typically involve state law claims. Several states, including states that frequently are the place of incorporation or derivative litigation, advance that interest by permitting objecting shareholders to appeal without intervening. If it concludes that no federal statute or rule expressly controls the issue in this case, the Court should take these strong state interests into account in determining whether an objecting shareholder in federal court must intervene to appeal. "Otherwise the accident of diversity of citizenship would constantly disturb equal administration of justice in coordinate state and federal courts sitting side by side."[26]

Since *Erie*,[27] federal courts sitting in diversity of citizenship cases have faced a variety of situations requiring this Court to determine the extent to which the federal system should apply state statutes, rules, or law rather than federal procedural statutes or rules. Although that question

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[25] See Amchem, 117 S. Ct. at 2248 (courts must enforce the Federal Rules of Civil Procedure as written).

[26] Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487, 496 (1941).

[27] Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938).

has often been troubling,[28] the Court has consistently interpreted the federal rules with sensitivity to important state interests and regulatory policies.[29] The principle it has followed is that, in the absence of a federal statute or rule directly on point,[30] state requirements that reflect important state policy interests should control in an action based on state law filed in federal court under diversity jurisdiction.[31] The objective is substantial uniformity of predictable outcome between federal and state courts.

For example, in *Walker*, the Court decided that a state rule rather than the federal rule on the time for commencing a civil action determined the date for assessing compliance with a state statute of limitations. Similarly, in *Gasperini*, the Court decided that the *Erie* doctrine required application of a New York statute empowering appellate courts to review the size of jury awards and order new trials when the amount materially deviated from reasonable compensation. It then reconciled the commands of the Seventh Amendment with the state interests protected by the *Erie* doctrine by ordering the federal trial court rather than the federal appellate court to apply the New York statute.

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[28] Walker v. Armco Steel Corp., 446 U.S. 740, 744 (1980).

[29] Gasperini v. Center for Humanities, Inc., 518 U.S. 415, 427 n.7 (1996). See also Richard H. Fallon et al., Hart and Wechsler's The Federal Courts and the Federal System 729 (4th ed. 1996) ("The Supreme Court has continued since [*Hanna v. Plumer*, 380 U.S. 460 (1965)] to interpret the federal rules to avoid conflict with important state regulatory policies."), quoted with approval in Gasperini, 518 U.S. at 437 n.22.

[30] See, e.g., Stewart Org., Inc. v. Ricoh Corp., 487 U.S. 22 (1988); Hanna v. Plumer, 380 U.S. 460 (1965).

[31] See Walker, 446 U.S. at 752.

The Court showed the same concern for accommodating state law interests in shareholder derivative cases brought in federal court. In *Cohen v. Beneficial Industrial Loan Corp.*,[32] the Court, observing that the difference between substantive and procedural rules was not always clear or dispositive, applied a statute of the forum state making certain unsuccessful shareholder plaintiffs liable for the legal fees and expenses of the defense and requiring the plaintiffs to post security for those amounts before the case could proceed. The Court recognized the important state interests underlying derivative cases; it described shareholder derivative actions as creatures of state law and said "the state has plenary power over this type of litigation."[33]

This respect for state interests should inform the Court's resolution of this case. In determining the rule for federal courts sitting in shareholder derivative cases based on diversity of citizenship, the Court should take into account that the practice in states commonly the location of incorporation or derivative actions is not to require intervention to preserve the right to appeal.

The practice in Delaware is particularly important because Delaware is the most favored state of incorporation[34] and is frequently the location of shareholder derivative litigation. Delaware has a trial court rule identical to Rule

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[32] 337 U.S. 541 (1949).

[33] 337 U.S. at 549-50, 555-57. See also Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90 (1991) (in a derivative action based on a federal claim, the Court decided as a matter of federal common law to incorporate state rules on the need to make a demand on the board and on demand futility rather than create a uniform federal rule).

[34] See Curtis Alva, Delaware and the Market for Corporate Charters: History and Agency, 15 Del. J. Corp. L. 885, 887 (1990).

23.1 and permits an objecting shareholder to appeal without intervening.[35]

Other states that are frequently the place of incorporation or the location of many derivative cases also permit an objecting shareholder or unnamed class member to appeal without first intervening. New York,[36] California,[37] and Illinois[38] are among them.

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[35] Prezeant v. De Angelis, 636 A.2d 915 (Del. 1994) (class action); Kahn v. Sullivan, 594 A.2d 48 (Del. 1991) (class and derivative actions); In re Resorts Int'l, 570 A.2d 259 (Del. 1990) (class and derivative actions).

[36] Jack Weinstein et al., New York Civil Practice: CPLR ¶ 5511.04 (1998) ("In some cases, the standing to appeal of persons who participated but were not technically 'parties' below will be fairly clear. In a stockholder's derivative action, for example, interested stockholders, other than the plaintiffs have been held to have standing to appeal from a judgment adverse to the class.") (citing Auerbach v. Bennett, 393 N.E.2d 994, 998-99 (N.Y. 1979) ("In view of the established rule that a dismissal on the merits of one derivative action is generally a bar to suits by stockholders of the same corporation on the same cause of action, we have no difficulty in recognizing one of the stockholders, who is within the class for whose benefit a derivative action has been instituted, as a party aggrieved by whom a notice of appeal may be filed . . . .") (citations omitted); Posen v. Cowdin, 44 N.Y.S.2d 842 (App. Div. 1943)).

[37] Rebney v. Wells Fargo Bank, N.A., 269 Cal. Rptr. 844, 852 (Ct. App. 1990) ("[A]ll [unnamed class members who object to a settlement] have to do is appear as objectors at the fairness hearing and then take an appeal."); Trotsky v. Los Angeles Fed. Sav. & Loan Assoc., 121 Cal. Rptr. 637, 640 (Ct. App. 1975) (class action); Jon Eisenberg et al., California Practice Guide ¶ 2:274.1 (1997) ("An unnamed class member who is aggrieved by settlement of the class action and who made an appearance to object to the settlement has standing to appeal a judgment approving the settlement.").

[38] Gowdey v. Commonwealth Edison Co., 345 N.E.2d 785 (Ill.

(continued...)

Because a federal intervention requirement would deter institutional investors from appealing and because appeals and the threat of appeals are likely to lead to different results in some cases, the presence of diversity could affect the outcome of a derivative case. That prospect implicates federalism and *Erie* concerns,[39] and therefore, in one of several possible ways, the Court should defer to the state approach. It should apply the relevant state rule governing appeals by objecting shareholders, construe the relevant federal rule to conform to the practice in the important states discussed above and not require intervention, or incorporate the state rule as a federal common law rule.

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[38] (...continued)
App. Ct. 1976) (class action). In Florida, by contrast, objectors must attempt to intervene before appealing. See, e.g., Ramos v. Philip Morris Cos., Inc., 714 So.2d 1146 (Fla. Dist. Ct. App. 1998) (class action).

[39] See Gasperini, 518 U.S. at 431 ("*Erie* precludes a recovery in federal court significantly larger than the recovery that would have been tolerated in state court.").

CONCLUSION

For the foregoing reasons, the Institutional Investors request that the Court reverse the Seventh Circuit and permit the Petitioners to appeal the district court's approval of the settlement in this case without first intervening.

Respectfully submitted,

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APPENDIX

LIST OF AMICI CURIAE

The amici curiae joining this brief are:

AFL-CIO Staff Retirement Plan

Barclays Global Investors, N.A.

California State Teachers' Retirement System

Los Angeles County Employees Retirement Association

National Industry Pension Fund

New York City Board of Education Retirement System

New York City Employees' Retirement System

New York City Fire Department Pension Fund

New York City Police Department Pension Fund

New York City Teachers' Retirement System

New York State Common Retirement Fund

New York State Teachers' Retirement System

State of Wisconsin Investment Board